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TELEGRAM

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ACTION: PRIORITY
AMERICAN EMBASSIES BRUSSELS, BONN, LUXEMBOURG, ROME, MADRID, LISBON, STOCKHOLM, OSLO, COPENHAGEN, DUBLIN, ATHENS, ANKARA, TOKYO, CANBERRA, BUENOS AIRES, NEW DELHI, RAWALPINDI ISLAMABAD, SEOUL, BRUSSELS EC

INF: AMERICAN EMBASSIES LONDON, PARIS, THE HAGUE, LAGOS, BOGOTA, QUITO, TEHRAN, TRIPOLI, JIDDA, KUWAIT, BEIRUT, ALGIERS, CARACAS, DJAKARTA, AMCONGEN DHAHRAN, BUENOS AIRES, OECD PARIS, NATO BRUSSELS

SUBJ: OPEC Demands, OPEC Solidarity; Oil Company Reactions and Plans

DEPARTMENT OF STATE A/CDC/MR
REVIEWED BY cf DATE 6/18/81
PORTIONS DENIED AS INDICATED

Summary

The price increases accepted by the oil producing compnies last Fall will add about $650 million to host government tax revenue in 1971. [redacted] This amount will also be added to oil costs to consuming countries to the extent companies are unable to absorb the cost increases themselves by reducing profits. The demands made by OPEC in December could add an additional $2 billion to 1971's taxes. If the most recent Libyan demands are met and carried through to the Persian Gulf, this figure could be doubled. Some increases will almost certainly have to be accepted but

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the companies hope to stand firm in the face of OPEC pressure and settle for something less than Libya has asked. In view of Libya's uniquely strong position resistance will be difficult. It will be impossible without the support of all or least most of the consuming countries.

Background

The Organization of Petroleum Exporting Countries (OPEC) was formed a decade ago to raise tax references prices (and hence taxes) back to the 1958 levels. It has been able to prevent any further decreases in these taxes, and it has succeeded in getting company agreement to pay above income taxes ~~xxxxxxxxx~~ royalties ~~xx xxxxxxx~~ but until recently it has failed in its prime objective.

To have been successful, OPEC would have had to have restricted production, creating supply shortages. This was strongly advocated by Venezuela and Iran but the proposal shattered on the inability of OPEC to agree on who was to cut his production and by how much. With a vast

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surplus production capacity, each producing country, while anxious to increase its income per barrel, was even more anxious to increase total income. And it appeared that the quickest, surest way of doing this was by increasing not by decreasing production.

1967 Middle East War and Aftermath

The closing of the Suez Canal in June 1967 changed the world oil market profoundly. A substantial tanker market was transformed overnight into a tanker shortage. However, through quick action of governments and companies, tankers were rerouted and production in short haul areas - particularly Libya - was increased. World consumption rose faster than expected, tankers were not available to bring the oil from the Persian Gulf and Libyan oil was not only ideally situated but was of exceptionally high quality. [redacted] B1

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But in September 1969 it was transformed into a radical Arab republic. Production in Libya nonetheless continued to grow and by mid 1970 Libya had surpassed Kuwait and was about to overtake Saudi Arabia, Iran and Venezuela to become the world's foremost oil exporter. Tanker rates had not fallen to pre 1967 levels but they appeared to be on a firmly downward course.

Then two events brought the world to edge of a new petroleum shortage: The ~~TXNXXXX~~ Trans Arabian Pipeline (Tapline) was cut in May and about 500,000 barrels day of short haul oil was lost; and shortly thereafter Libya "for conservation reasons" reduced production by over 750,000 barrels per day.

Libyan and OPEC Actions: September/October 1970

With great difficulty this additional strain was overcome; tanker cross hauls were eliminated, tanker overhauls were postponed, combination carriers were taken out of the ore and grain ~~X~~ trade and the world's oil demands were met. But the cost was high; tanker rates rose ~~X~~ to almost unprecedented levels and there were no more tankers available to meet additional crises.

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A crisis was soon created by Libya's new radical rulers who found themselves ideally suited to make new demands on the oil companies. Not only were tankers not available to shift production elsewhere, but Libya's currency reserves were so high it could afford to stop production completely.

The basic Libyan arguments were that Libyan oil had been underpriced for years and that the Libyan government was not adequately paid for the new transport advantage which its oil enjoyed. The government made its first demands of Occidental Petroleum Company as it was particularly vulnerable. It had already been attacked in the Libyan press for overproducing, hence inflicting permanent damage on the oil fields, for getting its concession from the old regime through suspect means and for having certain "Zionist" connections. The company therefore feared nationalization and as it had no other significant sources of crude oil to meet substantial commitments, it yielded to the government. Both its income tax level and its tax reference price were increased and the net increase in payments to the Libyan government was about 30 cents/barrel.

Oasis was the next target. While it was relatively safe on the issue of over-production and the validity of the concession, directors of two of the parent companies had been accused of being heavy contributors to Zionist causes and all of the companies

(except Shell) had little production outside of Libya. Oasis, too, collapsed and Libya was assured of 1.5 million barrels/day of production. This gave it an annual income of $750 million on which it could last indefinitely. The major oil companies considered defying the Libyan demands but while Libya could have survived easily without the major's production, Europe could not easily have foregone this 1.5 million barrels/day of oil particularly if, as seemed likely, Iraq had cut off its 1 million barrel/day of Mediterranean oil at the same time. Only a small part of the loss of this oil could have been made up elsewhere (because of the tanker shortage); and without rationing Europe's stocks would have been drawn down by thirty days supplies during the six winter months of 1970-71.

The major oil companies yielded to Libyan demands the end of September. The Persian Gulf producing governments then argued that Libya had been overcompensated for its transportation advantage and they too demanded immediate increases in taxes. They were given some price increases and an increase in income taxes to 55 percent. The net increase in payment to governments in the Persian Gulf was about 15 cents/barrel.

Venezuelan Action, Early December

Venezuela, which had long been in the forefront of OPEC and had pioneered most of the changes in company/government relations,

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found out that it had been surpassed by radical and even conservative Arabs and Iranians. It quickly reversed this unusual situation. The Venezuelan Congress had been faced with a budget deficit and, rather than accept an unpopular sales tax, it turned to the oil companies. New legislation raised the income tax which had been 52 percent to 60 percent and made it retroactive to January 1, 1970. The companies were faced with a substantial reduction in their profits for the year and no possibility of recouping them from the consumers. But even more disturbing was the second provision of the law which gave the government the right to set the tax reference prices at will, with no consideration given to selling prices. Theoretically, the taxes could be raised to 100 percent of actual profits. The companies, faced with this new uncertainty, cut back their plans to invest in Venezuela, and the USG was forced to review carefully all suggestions for special hemispheric treatment in its oil imports policy.

This Venezuelan action of course did not go unnoticed elsewhere. The retiring Secretary General of OPEC commented on this "historic precedent" which will result, he said, in all producing governments setting their own taxes from now on.

OPEC Actions - Early December

OPEC met in Caracas almost immediately after the Venezuelan legislation was passed. In a session which we understand was

noted for its militancy and the absence of moderate views, the organization decided to impose a series of new demands on the operating companies. Some oil companies blame Venezuela for the OPEC action on the basis of post Venezuela ergo propter Venezuela but there seems little authority for this reasoning. OPEC was flush with the victories in Libya and the Persian Gulf [redacted] (S)

A team composed of Iran, ~~XXXX~~ Iraq, Saudi Arabia and the new, highly competent SecGen of OPEC, Nadim Pachachi, are to start negotiations with the Consortium in Iran on January 12. The companies' representatives have told Iran that they cannot reach any decision then but will need to refer the demands to the parent companies boards; the Iranians have apparently agreed to a few days delay.

We cannot say yet precisely what OPEC will demand in Tehran. We suspect that OPEC itself has not yet decided but will try to get whatever it thinks the companies ~~X~~ can be forced to yield. Much depends on the outcome of other negotiations in Libya (discussed below). ~~[redacted]~~

The following is probably the minimum which OPEC would accept - barring unforeseen developments. The dollar figures are total increases in taxes in 1971.

Increase in posted price by 15 cents/bbl - $850 million

Increase short haul crude by 25 cents/bbl 525 million

Elimination OPEC allowances (Persian Gulf) 175 million

Price Equalization (Persian Gulf only) 400 million

Total $1,950 million

[redacted] Using Libyan crude as a base for other prices could increase this by still another $1 billion/year. In other words, if the OPEC demands are fully met, the additional tax income (and hence additional costs to consumers) could be between $2 and ~~X~~ $5 billion in 1971 and would increase with consumption and inflation in subsequent years. Increases in cost per barrel would vary with quality of crude and location, but would be between 25 cents and 60 cents. This of course is in addition to the 15-3[illegible] cents/barrel additional taxes given the producers in September and October 1970.

Most Recent Libyan Demands

As substantial as these figures are, the most recent Libyan demands are even higher. The Libyan government has just summoned Occidental and Bunker Hunt to Tripoli, has presented demands to both companies which must be accepted, not negotiated, by January 15.

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They are as follows:

- an increase in taxes by an additional five percentage points
- an increase in posted prices between 39 cents/barrel (Bunker Hunt) and 46 cents/barrel (Occidental)
- an increase in the posted prices of "short haul" crude by an additional 30 cents/barrel. This would vary with tanker rates and would be reviewed every six months.

(Together these increases would raise taxes by about 60 cents/barrel).

- in addition, the companies would be required to leave 25 cents/barrel in Libya for "further investment"

(Some but not all of this could come out of company profits.)

Libya and OPEC

It is not clear how the Libyan action meshes into the Tehran negotiations. Libya may be acting entirely on its own. Or it may be a part of a concerted OPEC plan to extract new payments from Occidental and other independents and then the major oil companies in Libya. Once this was achieved, OPEC would turn to the Persian Gulf producers. It is not too important, however, which thesis is correct.

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Company Reaction

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Company Proposals

Shell has proposed negotiating with OPEC as a whole - not just the Consortium in Iran - and is prepared to accept some increase in posted prices and some transport increment for short haul oil (although far less than the Libyans have demanded). It would agree to 55 percent income tax and to tie further increases to some international price index. In return for this OPEC, Shell hopes, would agree to a period of stability in which no further increases would be imposed on them or on the consumers. The American companies, of course, will require Justice Department approval - which they are now seeking - before they can join such a common front.

The most pressing problem is the Libyan attempt to crack the

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companies one by one. The companies operating there have proposed a mutual assistance agreement, to help any company the Libyans move against. Occidental, Bunker Hunt, Marathon and Continental and Amerada, the companies threatened or about to be threatened (if Libya follows its pattern of last summer) have tentatively agreed - provided the assistance can be real; four of the American majors, British Petroleum and Shell are also ready to work out some arrangement. Again, this depends on Justice Department clearance which is being sought.

Government Action

Representatives of the US, UK, France, and the Netherlands met in Washington early last week before details of the Libyan demands were known to discuss the OPEC demands. [redacted] B1

[redacted] (The US referred to the need for Justice Dept approval before the US companies could participate in any action).

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The need for very close coordination among consumers was noted. (The US is the world's largest consumer and the second largest importer of oil). The possibility of joint consumer action

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was discussed but no conclusions were reached other than that it might be necessary to tighten belts [redacted] somewhat if any country - notably Libya - cut off supplies.

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posts, including those in areas where other countries have prime responsibility - most especially Brussels EC and Bonn - should discuss this telegram urgently with appropriate officials, and ask their views.

London, Paris and The Hague should be given the latest information on developments in Libya. Other info Embassies and Dhahran, without approaching governments directly, should give us their assessment of views of host governments, the government position in OPEC [redacted]

[redacted]

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